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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE trend of industry and trade has been towards betterment since the first of the year, the chief evidences of this being in the automobile and steel industries. The annual automobile shows were well attended and a large public interest shown. Volume of orders placed was said to be satisfactory, and makers have been increasing production in anticipation of an active Spring business. Notwithstanding that production of the Ford Company is being increased only slowly, factory employment at Detroit is running ahead of a year ago, and a better showing for first quarter production figures than last year is confidently predicted.

With the automobile industry on the upgrade of activity, the steel business has been favorably affected. Larger orders by automobile interests and substantial railroad buying of rails and rolling stock late in December were reflected in an increase of 518,430 tons in the unfilled orders of the Steel Corporation. As general buying in January has kept up at a good rate for this time of year unfilled orders on the 31st are expected to show a further rise despite an increase in production and deliveries during the month. From the low point of 60 per cent reached in December ingot production of the Steel Corporation has got up to 83 per cent, while the average for the independents is in the neighborhood of 72 per cent, compared with 55 per cent at the December low. Taking the industry as a whole, operations around 77 to 78 per cent are about equal to those at this time a year ago, and according to the Iron Age it is believed possible that they may again approach the record established in March last year at about 93 per cent. At that time it will be recalled that the Steel Corporation was operating practically at 100 per cent. Not only is production of steel improving, but what is equally important the price structure is firmer, bars, shapes, and plates having been advanced for the second time during the past three months, so that all in all the outlook in the industry is more encouraging than in some time.

Outside of these two major lines, business shows more irregularity. On the whole, however, the trend has been forward, and the outlook for Spring trade is appreciably brighter. So widely has the policy of reducing stocks been practiced that there exists a large backlog of unfilled demand in many branches of industry which is now beginning to be translated into orders.

January retail trade has been occupied chiefly with the usual post-holiday sales, with seasonal movement of winter apparel much retarded by the warm weather. The prevalence during most of the month of moderate temperatures has worked a serious hardship on clothing lines, and the season in those trades is said to have been one of the worst in years. Coal has likewise been hurt by the warm weather, while building and dependent lines, on the other hand, have generally benefited.

The cotton spinning industry, whose activity last year tended to sustain business in the face of declines in the heavier industries, is undergoing curtailment as the result of overproduction. Thanks to the information now available to the industry through the offices of the Cotton Textile Institute, the mills have been apprised of the accumulation of goods and have been enabled to take steps to avoid the serious overproduction which in the past has usually followed periods of unusual activity such as the last year. With the slowing down of business, however, the move towards wage reductions, initiated during the past few months, has been spreading further among the New England mills. The fact that these reductions (10 per cent in most cases), are being generally accepted by the workers without contest is in itself strong evidence of the difficult position of the New England branch of the industry, due to relatively high production costs and Southern mill competition. Generally speaking, the Southern mills had a good year in 1927 and wages in that section are not expected to be disturbed.

The shoe industry during the latter part of last Summer and in the early Fall experienced quite a revival of activity, and shoe plants reached the highest point of production in several years. For some of the larger companies making a medium priced shoe, such as Inter-

national Shoe Company and Endicott-Johnson, and others which have an outlet through the chain stores, the year has been a good one. Recent reports, however, of wage cuts and resulting strikes which have shut down most of the factories in Haverhill, Massachusetts, are evidence of difficulties in some branches of the industry. As in the case of the textile industry the constant broadening out of the shoe industry into other parts of the country is creating keen competition for the older centers.

The Rise in Hide and Leather Prices

One of the immediate problems with which the shoe industry is having to contend is that created by rising prices of hides and leather. During the past year prices of hides have risen 65 to 75 per cent, and leather prices though not yet fully discounting the advance in hides, have also had a substantial increase. That shoe prices in turn will have to be advanced to conform to the trend of hides and leather would seem to be inevitable. As a sample of what has been taking place in basic leather and shoe costs the following table of hide prices is of decided interest:

HIDE PRICES
(Source: "Hide and Leather")

	Packer Heavy Native Steers	Butt Branded Steers (Packer)	Packer Light Native Cows	Country Heavy Cows	Country Extremes
Avg. for 1913..	18.3c	17.4c	17.2c	14.9c	15.5c
Avg. for 1926..	14.0	13.3	13.0	9.6	13.1
Jan., 1927..........	15.5	14.7	14.1	10.9	14.5
June, 1927........	19.5	18.0	20.0	15.6	19.8
Dec., 1927..........	25.0	24.2	22.7	19.0	22.5

Hide prices, moreover, have continued to display strength in January, packer hides showing a further advance to 26½ cents, a new high level for recent years. This advance is the more notable by reason of the fact that the seasonal trend is usually downward at this time owing to the poorer quality of the hides coming on the market in the winter.

Advances in hide and leather prices have as their basis the world wide exhaustion of surplus supplies. Commenting on the situation as to leather in a recent address before the annual convention of the shoe manufacturers' association, Fraser M. Moffat, President of the Tanners Council, said:

> During the past year stocks of leather of all kinds in this country have decreased in percentages ranging from 32 per cent in the case of sole leather to 10 per cent in other lines. In many instances stocks of leather are at their lowest record point. In sole leather in which you are all interested and which is particularly vital because of the long time necessary to produce it, there is practically no visible supply unsold. My reason for stating this fact in this way is that most tanners have orders ahead for at least 30 days and with a visible supply which will be shown on the 1st of January as approximately 1,700,000 sides, corresponding to a little more than a month's normal consumption, you can easily see the reason for my statement.

As to the hide situation, the available statistics indicate that the supply in this country during 1927 was somewhat larger than in 1926. The domestic slaughter showed a decrease owing to the shortage of cattle, but this decline was more than offset by increased imports, the net excess of imports over exports of hides for the period January through November being 350,469,000 pounds as against 279,123,000 pounds in the same period of 1926. The grand total increase, however, in available supplies, including domestic slaughter, was moderate and counterbalanced by increased consumption. With boot and shoe production last year some 6 per cent larger than in 1926, total stocks of hides and leather on the latest available reporting date, November 30, 1927, were approximately 11 per cent less than a year previous. Following is a table which gives comparative figures:

(Unit: 1,000 hides)

	Raw Hides On Hand	Hides in Process	Finished Stocks	Total raw & Process stocks, & finished leather in hands of Tanners
Feb., 1923......	6,772	6,323	7,024	16,896
Oct., 1925......	3,757	5,291	5,012	11,581
Oct., 1926......	4,116	5,347	3,539	10,468
Sept., 1927......	3,517	4,842	2,569	8,765
Oct., 1927......	3,733	4,880	2,581	8,972
Nov., 1927......	3,779	4,916	2,590	9,075

While raw hide stocks and hides in process have shown some increase in recent months this increase is significant only of a moderate amount of activity on the part of the tanners in the replacement of stocks which had got down to about the absolute minimum. Despite the continued strength of hide prices the trade feels very uncertain as to the future trend and tanners are cutting their operations as closely as possible pending a rise in leather to nearer replacement values. The statistical position is admittedly strong, but the extent of the price rise that has taken place and the possibility of the increased use of leather substitutes is influencing the industry to a conservative course with respect to its commitments.

Fourth Quarter Business Slump Revealed

Fourth quarter business comparisons now coming to light reveal the extent of the business slump which occurred during that period. Railway carloadings amounting to 12,903,546 cars, were 8 per cent smaller than in the corresponding period of 1926 and 6 per cent below those of the same period of 1925. Reflecting the decline in traffic gross railway revenues for the month of November fell nearly 10½ per cent below those of November, 1926, while net income was off 25 per cent, and at the rate of only 3.71 per cent on the carriers' property investment. For December the preliminary reports indicate a still more unfavorable showing, the returns for 30 roads thus far published showing a decline of 11.6 and 27.7 per cent respectively in gross and net as compared with December a year ago.

Reports on factory employment make a similar showing of lessened industrial activity. According to the United States Department of Labor employment in manufacturing during November was the lowest of any month since July, 1924, the average being approximately 5½ per cent below that of November, 1926. For the month of December the New York State report indicated not only the lowest level of employment for the year, but a level lower even than that reached in December, 1921.

Circumstances contributing to this decline have been chiefly the curtailment in steel mill operations and the extraordinary shrinkage in automobile production, the output of motor vehicles in December being the smallest in five years. Both of these industries are now well on the way to recovery, and the automobile industry in particular looks forward to a year of large volume production.

While business in the aggregate during the first quarter of 1928 may not run as high as in the first quarter of 1927, substantial increases are expected to occur in a number of important lines, according to estimates of railway car requirements submitted to the car service division of the American Railway Association by Shippers' Advisory Boards covering the entire United States. First quarter freight car requirements for automobile shipments are expected to be 12½ per cent in excess of requirements last year, and substantial increases are expected also for brick and clay products, agricultural implements, fertilizers, chemicals and explosives, paper, and cement. Principal decreases are expected to occur in coal and agricultural commodities, particularly cotton and its products.

Following is a table comparing the estimated car requirements for the first quarter with actual loadings last year by twenty-seven commodity classifications:

Commodity	Per Cent Change 1928 from 1927
Grain, all	– 1.5
Flour, meal and other mill products	+ 3.0
Hay, straw and alfalfa	– 5.9
Cotton	–30.7
Cotton seed and products, except oil	–30.0
Citrus fruits	–11.8
Other fresh fruits	–17.3
Potatoes	+ 4.8
Other fresh vegetables	– 6.7
Live stock	– 2.0
Coal and coke	– 6.1
Ore and concentrates	– 2.9
Clay, gravel, sand and stone	+ .6
Lumber and forest products	+ .3
Petroleum and petroleum products	+ 4.4
Sugar, syrup, glucose and molasses	+ 4.9
Iron and steel	– 1.4
Castings, machinery and boilers	– .9
Cement	+ 3.6
Brick and clay products	+ 6.4
Lime and plaster	+ .8
Agricultural implements and vehicles	+ 7.4
Automobiles, trucks and parts	+12.5
Fertilizers, all kinds	+ 9.3
Paper, printed matter and books	+13.9
Chemicals and explosives	+ 7.3
Canned goods	+ 1.9
Total All Commodities Listed	– 2.3

The Live Stock Industry

The United States Department of Agriculture has made public the following estimates of live stock on farms and ranges in this country as of January 1, 1928, with comparative figures for the two years next preceding:

	January 1		
	1928	1927	1926
Horses and Colts	14,541,000	15,145,000	15,830,000
Mules and Mule Colts	5,566,000	5,679,000	5,739,000
All Cattle and Calves	55,696,000	56,872,000	59,122,000
Cows and Heifers 2 years old and over kept for milk	21,948,000	21,818,000	22,188,000
Heifers 1 to 2 years old being kept for milk cows	4,175,000	4,048,000	3,916,000
Sheep and Lambs	44,545,000	41,846,000	39,730,000
Swine including Pigs	58,969,000	54,408,000	52,148,000

The Department figures for receipts of live stock at all public markets in this country in the years from 1920 to 1927 are as follows:

Year	Cattle	Calves	Hogs	Sheep
1927	16,258,224	6,504,630	41,410,686	23,934,661
1926	17,034,319	6,837,231	39,771,596	23,868,133
1925	17,116,787	6,949,897	43,928,755	22,100,393
1924	17,172,899	6,522,508	55,414,449	22,200,645
1923	16,999,285	6,211,722	55,329,843	22,025,386
1922	17,141,184	6,076,943	44,067,509	22,364,475
1921	14,310,145	5,476,649	41,100,989	24,168,032
1920	16,860,204	5,337,291	42,121,255	23,537,534

Beef Cattle

The beef cattle industry has emerged from the slough of despond in which it has been struggling since 1919. The Secretary of Agriculture, in a recent statement, summarized the story of the great decline of prices, as follows:

> Here is what has taken place in the cattle industry in the last ten years: Cattle production was greatly expanded during the war in response to demands for adequate supplies of beef for the allied forces. When the war closed the industry found itself with the largest number of cattle on hand and the largest potential production capacity in the history of the country—both much in excess of ordinary peace time requirements at remunerative prices.
>
> During 1920 and 1921 there was a decline in cattle prices of over 60 per cent in 16 months and for the next four years enforced liquidation held prices at extremely low levels, actually below pre-war prices over a considerable period of time. During this period cattle slaughter greatly exceeded production and cattle numbers declined 11,000,000 head or 17 per cent in seven years.

The effects of the war upon the cattle industry as described by the Secretary illustrate its effects upon agriculture generally. They are being gradually overcome in all lines by the natural readjustments.

Symptoms of a pronounced change in the cattle industry have been apparent for several years and in the last year a general advance has taken place in all kinds of cattle, including cows and calves. In but few years in the history of the cattle business have values been marked up so rapidly.

The Hog Situation

The hog situation makes a different story, prices being $3.00 to $4.00 lower than one year ago, and this is now the chief subject of complaint in the Middle West. The explanation is to be found in increased receipts, as shown in

the table above, and declining exports of pork products. The latter in 1927 aggregated 986,023,000 pounds of the value of $145,563,293, against 1,123,861,000 pounds of the value of $197,201,036 in 1926. The increase in hog production was 4.1 per cent and the decrease in exports was 12 per cent in quantity and 26 per cent in value. In the week ended January 28 hog receipts at Chicago were 276,000 head, or 100,000 in excess of the corresponding week of 1927.

The hog producers have been quite inclined to place the blame for the decline in hogs upon the packers, but the results of the packing industry in 1927 as shown by the company reports now available afford convincing evidence that the packers did not have even average profits. The President of Armour & Company, in his statement to stockholders, explained that the unsatisfactory results were due primarily to "steadily declining prices for live hogs, causing heavy inventory losses on pork products."

The table below shows the earnings of each of the "big four" in the years 1926 and 1927, per cent of profit on sales and on investments, dividends paid, surplus or deficit after dividends, and amount of borrowed capital employed in the business.

It will be seen that the profit per dollar of products sold ranged from .05 of 1 per cent to 1.32 per cent. The percentage of earnings on capital shown includes nothing for profit on borrowed money, of which all the packers use very large sums.

A popular opinion persists that the packing industry is one of large profits and that the packers are able to make prices and profits about as they please, but records of recent years do not support this view. The figures for the four leading companies in the last two years are seen above, and figures for the aggregate net income of the companies fortunate enough to have net incomes, and of the aggregate deficit of the companies having deficits for each year from 1918 to 1924, as shown by the reports of the Bureau of Internal Revenue, are given at the top of the page.

	Reporting net income		Reporting deficit	
Year	Number	Net income after taxes	Number	Deficit
1918	331	$ 19,439,519	79	$ 1,293,055
1919	303	17,984,423	117	47,701,513
1920	293	10,391,928	187	26,438,149
1921	315	21,065,427	191	73,188,479
1922	360	35,674,372	184	32,502,278
1923	400	52,542,069	174	6,894,178
1924	426	49,065,132	166	15,527,752
7 Years		$206,162,870		$203,545,404

These figures show that in these seven years for each $1.00 made by the companies realizing profits, 98 cents were lost by companies having deficits. Since 1924 the figures for meat packing companies have been consolidated with companies producing other food products and cannot be obtained separately.

Money and Banking

Advances in the rediscount rates of the Federal Reserve Banks of Chicago and Richmond in January have once more brought the money situation under careful scrutiny. For some time it has been apparent that events were shaping themselves towards a firmer level of interest rates. The rapid expansion of bank credit which has taken place over the past year made it only a question of time when some measures of restraint would have to be imposed, and the Reserve authorities have apparently decided that the present is the proper time to act.

Early indications of a new trend in money appeared in fractional advances in rates for Stock Exchange time money and bankers acceptances shortly after the first of the year, a time when the tendency of money is usually towards lower levels. This significant firming of long time money was rather lost sight of for a time due to the large return flow of currency to the banks which always occurs in January after the holiday trade and which caused such flush offerings of call money that the rate on several days declined to 3½ per cent. The hand of the Reserve banks, however, in keeping a firm rein on the market was seen in a heavy liquidation by them of Government securities spread over the three weeks ended

OPERATING DETAILS FROM PUBLISHED STOCKHOLDERS REPORTS OF THE "BIG FOUR" MEAT PACKING COMPANIES

	SWIFT & CO.		ARMOUR & CO.		WILSON & CO., Inc.		CUDAHY PACKING CO.		"BIG FOUR" COMBINED	
	Year ended Nov. 6, '26	Year ended Nov. 5, '27	10 Mos. ended Oct. 30, '26	Year ended Oct. 29, 27	8 Mos. ended Oct. 30, '26	Year ended Oct. 29, '27	Year ended Oct. 30, '26	Year ended Oct. 29, 27	1926 Period	1927 Period
Sales	$950,000,000	$925,000,000	$750,000,000	$900,000,000	$195,000,000	$285,000,000	$231,726,645	$233,325,368	$2,126,726,645	$2,343,325,368
Net profits	15,645,242	12,203,492	8,148,570	538,175	3,268,474	147,396	4,052,780	2,353,959	31,115,066	15,242,022
Dividends	12,000,000	12,000,000	7,901,928	9,168,514	999,439	None	2,119,124	2,278,495	23,020,491	23,447,009
Year's Surplus or deficit	3,645,242	202,492	246,642	def.8,630,339	2,269,035	147,396	1,933,656	75,464	8,094,575	Def. 8,204,987
Capital and surplus	223,124,210	223,326,702	288,084,216	279,002,676	61,276,554	61,401,833	39,801,943	39,877,407	612,286,923	603,608,618
Total interest bearing debt	86,973,270	84,135,420	168,515,200	163,974,580	28,810,242	28,222,421	31,637,821	33,575,100	315,936,583	309,907,521
Profit per dollar of sales	1.65c	1.32c	1.09c	0.06c	1.68c	0.05c	1.75c	1.01c	1.47c	0.65c
Profit per dollar of invested capital	7.02%	5.47%	2.83%	0.19%	5.34%	0.24%	10.20%	5.90%	5.08%	2.52%

January 25 and amounting to $186,000,000. Counting discounted bills and bills purchased in the open market, the net reduction of total Federal Reserve credit outstanding from the December peak to January 25 amounted to $425,000,000. While this aggregate decrease all had the effect of absorbing credit, the decline in Government security holdings was particularly important because of the insight which it gave into Reserve bank policy. The Reserve banks take the initiative in these dealings and influence the market intentionally—in this instance in the direction of higher levels.

No Shortage of Funds for Commercial Purposes

There is nothing in this evident change of policy on the part of the Reserve banks to suggest that business may not continue to count upon having all the funds it needs for its legitimate purposes at moderate rates for an indefinite time ahead. There is no prospect of a shortage of credit in this country. The change, however, does convey the implication that money supplies are likely to be more closely adjusted to demand than they have been in the past and that rates are headed for somewhat higher levels.

During the past year an unusual combination of circumstances has tended to make money rates abnormally easy. Substantial imports of gold in the early part of the year, a decline in commercial requirements for credit and currency, and the easy money policy of the Federal Reserve banks have all contributed to increase the supply of available funds and depress the level of rates.

Looking now into the coming months, it does not appear likely that these factors will continue to be influential. Our gold export movement has slowed down with the reaction of the foreign exchanges, but gold imports on balance in any substantial volume are at least not an immediate prospect. The country's credit and currency needs are likely to expand as general business increases in activity and volume. As to Reserve bank policy, the Reserve banks by their selling of Government securities and advances in rates have already given notice of a modification.

The Expansion of Credit

Reference has been made repeatedly in this Letter to the large expansion of bank credit in progress last year as result of the unusual ease of money. A measure of this increase may be seen in the figures of the weekly reporting member banks of the Federal Reserve System whose loans and investments rose by almost two billion dollars, or nearly 10 per cent, during the twelve months' period, a rise which more than doubles anything which might be viewed as a normal annual rate of bank expansion. Inasmuch as business was declining during the period and so had little use for additional funds, practically the whole of this expansion took place in loans on stocks and bonds or in purchases of securities outright by the banks for their own investment. This inflow of funds into the security markets has been an important factor in the great rise in security prices that has taken place.

Brokers' Loans at Record Levels

The principal measure of the volume of funds being employed in the security markets is the amount of brokers' loans at New York City. The total of these loans has increased very rapidly during the past year and on January 1 reached the record level of $4,433,000,000, an increase of $1,140,000,000 over the total of the previous January and of $897,000,000 over the level at which it stood just prior to the break in the market in the Spring of 1926. The extraordinary character of these advances, particularly in the last few months, has excited widespread comment and has not only called into question the validity of the general advance in market values, but has given rise to the charge that the Stock Exchange is absorbing an undue share of the country's credit supplies to the detriment of the commercial and agricultural interests of the country. On January 18 Senator La Follette introduced into the Senate a resolution asking the Reserve Board to take steps to curtail brokerage loans on the ground that the large amount of such loans represented funds transferred to New York from the interior of the country "where farmers, merchants, and manufacturers still are paying excessive rates of interest."

Brokerage Loan Increase Not at the Cost of Commercial Interests

Whatever may be one's views as to the soundness of the present Stock Exchange loan position, there is no justification for the contention that these loans represent funds withheld from business or agriculture. The funds which have come to New York consist of the country's surplus of available bank credit over the needs for it at home. During the past year, for reasons already described, funds have been available for employment more rapidly than they could be absorbed by the country's ordinary needs and bankers have been glad to send the surplus to New York to earn whatever it could in the call money market. With the call rates frequently as low as 3½ per cent during recent months it should be obvious that bankers would have had little incentive to send money to New York had there been any chance of employing it safely and profitably at home. As a matter of fact, there has seldom been a time when the volume of

credit available for legitimate agricultural and commercial needs has been as great as during the past year.

Brokerage Loans and the Stock Market

The question, however, as to whether brokerage loans are too high for the good of the market is another matter and one less susceptible of definite answer. One great difficulty is that the volume of securities listed on the Exchange has been increasing very largely in recent years, so that to some extent at least the volume of loans might be expected to increase. Moreover, inasmuch as there is no separation of the borrowings on stocks from those on bonds the figures are likely to be affected somewhat by the amount of new financing in process of distribution.

How large a factor the volume of undigested securities may be in the loan totals is impossible to say precisely. In general, our own observation is that despite the large volume of new security issues in the past few months the shelves of dealers are remarkably clean. There appears to be a tremendous appetite for securities on the part of a large variety of investors. So far as Wall Street is concerned the undigested security situation is clean, but this does not mean that the public may not be borrowing against these securities at its own banks. The great rise that has taken place during the past year in bank loans secured by stocks and bonds indicates very clearly that not all of the new issues have been absorbed out of savings, and, indeed, it could scarcely be expected that they would be in so short a period.

So far as the margin situation in the stock market is concerned this appears to be unusually sound. The practice of the Business Conduct Committee of the Exchange in circulating questionnaires among the Stock Exchange houses at various times during the year has had a salutary effect in keeping the margin situation in good shape. Brokers themselves in recent years have put large additional amounts of their own capital in their businesses, and during the past year, by reason of the rapid rise of prices, have tended to require larger margins of their clients.

This situation as to margins and the absence of any congestion of securities in dealers' hands are reassuring elements in the stock market situation.

Ratio of Loans to Market Value of Listed Stocks

Of particular interest in connection with this question of brokerage loans are figures recently published by the Stock Exchange comparing brokerage loans with the total market value of all listed stocks each month since the beginning of 1926. These figures are as follows:

COMPARISON OF BROKERAGE LOANS AND TOTAL MARKET VALUE OF ALL LISTED STOCKS

1926 First of Month	Total Loans	Total Market Value of Stock	Per Cent of Loans to Market Value of Stock
February	$3,513,174,154	$35,179,021,114	9.98
March	3,535,590,321	34,533,916,094	10.23
April	3,000,096,167	32,270,747,369	9.29
May	2,835,718,509	33,456,926,872	8.47
June	2,767,400,514	34,128,619,737	8.11
July	2,926,298,345	35,605,119,753	8.21
August	2,997,759,527	36,786,266,896	8.14
September	3,142,148,068	37,115,471,937	8.46
October	3,218,937,010	37,300,697,103	8.62
November	3,111,176,925	36,296,302,537	8.57
December	3,129,161,675	37,034,394,712	8.44
1927			
January	$3,292,860,255	$38,376,162,138	8.58
February	3,138,786,338	38,602,044,866	8.13
March	3,256,459,379	39,966,306,016	8.14
April	3,289,781,174	40,126,835,948	8.19
May	3,341,209,847	40,507,450,825	8.24
June	3,457,869,029	42,529,863,513	8.13
July	3,568,966,843	41,963,647,182	8.50
August	3,641,695,290	44,909,464,478	8.10
September	3,673,891,333	45,531,368,411	8.06
October	3,914,626,570	47,609,636,595	8.22
November	3,946,137,374	46,028,970,485	8.57
December	4,091,836,303	48,526,525,537	8.43
1928			
January	$4,432,907,321	$49,736,350,946	8.91

It will be observed that the percentage of loans to market values of listed shares has risen substantially in the past few months and on January 1 was the highest since April 1, 1926. Though it is still below the levels reached on February 1 and March 1, 1926, just prior to the break in security values of that year, certain features of the listings of the past two years should be borne in mind, which, if allowed for, would seem to make the market position still less secure than the above figures indicate. During this period an important number of high grade stocks have been brought out and sold to investors. The market value of these stocks of course is reflected in the listings but as most of this stock has been taken out of the market these additional listings have not correspondingly increased the floating supply of stock against which money is borrowed. In other words, the percentage of loans to the floating supply of active stocks is probably considerably nearer to the 1926 high levels than the published figures would indicate.

The Reserve Banks and the Market

The Reserve banks have not been insensible to the effect of their easy money policy on the security market. They have had no desire to give encouragement to excessive speculative activity, but they have had to be guided by the necessity of following a rate policy designed to repel rather than attract gold, and this has meant a policy of keeping rates in this country below those in European markets.

The period, however, of seasonal commodity shipments, when pressure on the exchanges is most likely to result in gold imports, is now over. Instead of our importing gold, the movement has been the other way, and since

September 1 we have had a net loss in our gold stocks amounting to more than $225,000,000. Partly because of this redistribution of our gold holdings the monetary situation abroad has considerably improved, so that it is now possible for our Reserve authorities to give less weight to international considerations.

With the situation abroad better and the danger of gold imports averted, it was hardly to be expected that the Reserve banks would continue much longer a policy which was resulting in a continuous expansion of our banking liabilities on the one hand and a decrease in our banking reserves through exports on the other. There is no reason to believe, however, that anything in the way of drastic action is contemplated by the Reserve banks. Our reserve supplies of credit are not in danger, and what is needed is not so much a protection of them as a limitation of the volume of credit to such amounts as the community can healthfully absorb.

The Advances in Bank Rates

That the initiation of a firmer rate policy by the Reserve banks should take place in some of the interior districts rather than at New York is a logical consequence of the fact that most of the money that has gone into the increase of brokers' loans in the past two months has come from outside New York City. To be exact, out of an increase of $277,000,000 in the volume of loans which New York banks have placed with brokers since the first of December, $202,000,000, or almost three-quarters, has represented loans placed for the account of out-of-town correspondents. While the loans of New York banks for their own account showed a temporary increase over the year-end they went off rapidly in the early weeks of January and by the latter part of the month were no higher than two months previous. This being the case, the raising of rates in the interior as a means of tightening money at the source of supply was clearly in order.

This action by the interior Reserve banks tends to set up a current of funds from other points to those districts in which the rates have been raised. Influenced by the higher rediscount rates, member banks in the districts affected are induced to withdraw such funds as they may have at New York or other centers and use the proceeds to reduce borrowings at the local Reserve banks. While figures on the Richmond district subsequent to the rate advance are not yet available, those for the Chicago district are of interest. Immediately after the rate advance in that district, gold holdings of the Federal Reserve Bank of Chicago increased $16,000,000, indicating a movement of funds into that district, while rediscounts of the member banks at the Chicago Federal Reserve Bank dropped $19,000,000. At the same time brokers' loans placed by New York banks for account of out-of-town correspondents showed a decrease, call money rates stiffened, and rediscounts at New York increased, suggesting a movement of funds out of this center.

With Reserve bank policy revealed in favor of dearer money, speculation naturally centers on the likelihood of advances in rates in other districts and particularly in the New York district. Doubtless further action will depend a good deal upon the results achieved by the steps already taken. The opinion has been generally held that action at New York would follow rather than precede that in other districts, but recent advances in open market bill rates to 3½ per cent, the same level as the official rediscount rate, place the market in a position where an advance in the New York bank rate at any time must be considered a possibility. At the same time it should be recognized that the rate policy of the New York Reserve bank, because of the position of New York as a world money center, has to take account of factors which might not enter into the decisions in other districts and until the trend of monetary conditions abroad can be established and the probable effect of a higher bank rate here on exchange rates and gold movements be appraised, directors of the local Reserve institution are likely to proceed with unusual caution.

Gold Movements

Gold imports and exports of the United States during January have come nearer to offsetting each other than in any month since October. Total exports thus far reported of $50,732,000, compared with imports of $38,300,000 leaving a net export balance of $12,432,000, as against $67,039,000 in December, $53,183,276 in November, $8,641,423 in October, and $11,465,386 in September.

Imports have been almost entirely from Canada, the total since January 1 being $37,700,000, and since the movement began in December $46,988,984. Inflow of gold from Canada at this time of year is a seasonal occurrence resulting from the closing of Canadian navigation in the winter.

Exports were principally to the Argentine and Brazil, bringing the total from the United States to these two countries since September 1 to $81,140,000 and $44,810,000 respectively. Exports to Europe, which in December amounted to $34,825,334, decreased to $14,200,000 in January, accompanying a decline in European exchange rates.

Credit Conditions Abroad

Abroad, money has been generally easier since the beginning of the year. The Bank of England has been able to add £6,276,000 to

its gold stocks since the first of December, bringing these holdings to £156,194,000, the highest since October 7, 1925. Increase of gold holdings together with a seasonal decline in notes and deposits brought the bank's ratio of gold to liabilities on January 25 to 35.85 per cent, the highest level since 1914. Accompanying these changes, open market rates eased sharply, the rate for 3 months' bills dropping from $4\frac{5}{16}$-$4\frac{3}{8}$ per cent to $3\frac{15}{16}$-4 per cent, or approximately one-half of one per cent under the bank rate. So marked an easing led for a time to some expectation of a lowering of the bank rate, but with evidences of firmer money in the United States, and the reaction of sterling from \$4.88$\frac{7}{16}$ to \$4.87$\frac{3}{16}$, this is not now regarded as probable, and bill rates have hardened somewhat.

The French money market continues to reflect the heavy influx of funds from abroad. On January 11 foreign exchange holdings of the Bank of France reached a new high level of 27,790,555,000 francs, or in excess of a billion dollars. In an effort to bring the bank rate more in line with the low rates that have prevailed for private discounts, the Bank of France has cut its official rate of discount twice in the past five weeks,—from 5 to 4 per cent on December 29, and from 4 to 3½ per cent on January 19, the latter rate being the lowest established since the outbreak of the war. With the Bank of France actually embarrassed by the plentitude of foreign exchange, the French Government decided in January to remove the ban on the export of capital established in 1918 and to once more permit free dealings in foreign exchange and foreign securities.

A further development of interest in the French situation was the announcement by our State Department that it no longer looked with disfavor on the flotation of French industrial loans in this market. While at one time this might have meant considerable French borrowing here, the situation is now different and there is little need on the part of the French for American loans.

Both the Berlin and Amsterdam markets have displayed ease and possibilities of bank rate reductions have been discussed in both places. Other changes during the month were a lowering of the bank rate of Austria from 6½ to 6 per cent on January 28, and an advance in the discount rate of the Bank of Belgium from 4½ to 5 per cent.

The Bond Market

Except for slight hesitancy late in the month due to a general uncertainty over Federal Reserve rediscount rates, the bond market during the month was active and firm in all departments. The most interesting feature of the present market, and that of 1927, has been not so much the steady climb in prices in the face of a huge volume of new issues as the unusual combination of favorable factors tending to make this the greatest bond market of all time. Other periods of rising bond prices have usually been periods of industrial and trade depression. The year 1927, on the other hand, has been a period of comparative prosperity, and bond purchases are coming from every quarter.

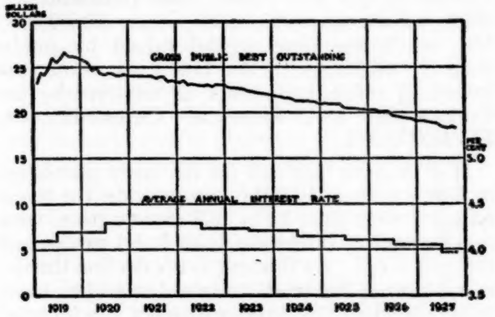
The Dow-Jones average of forty listed domestic corporate issues (10 high-grade rails, 10 second-grade rails, 10 industrials and 10 public utilities) reached a new high during the month of 99.48. On January 25th this average was 99.34, as compared with 96.67 on January 25th a year ago and 93.82 on the same date in 1926. Among the various classes of bonds used in the table, second-grade rails, public utilities and industrials all made new record high prices.

United States Treasury Finance

As a first step in its 1928 refunding program, the Treasury Department announced early in the month an offering of Five-year 3½ per cent Treasury obligations in exchange for the Third 4¼ per cent issue maturing on September 15th next, about \$2,150,000,000 of which were still outstanding. The offer repeats almost exactly the first offer made last March to holders of Second Liberty Bonds. It was theoretically possible for all holders of Second Liberties to have accepted this first exchange offer last March, and thus to have concluded the refunding operation. Out of a total of \$3,104,000,000 outstanding, however, only \$1,354,000,000 were actually turned in and the Treasury had to make three more offers, each somewhat different in character, before the old loan was extinguished, and still about \$732,000,000 were outstanding in the hands of investors on the due date. Returns so far compiled indicate that between \$600,000,000 and \$620,000,000 of Third Liberties have come in in response to the Treasury's first offer.

Treasury refunding operations during the past year throw considerable light on Government policy towards its debt. Before the war when large issues matured and the money market was favorable for refunding, it was not unusual for the Government to issue a new loan for the same amount and for the same period of years as the old. Several smaller issues approaching maturity were sometimes consolidated into a single long term loan. Present offerings of shorter term obligations apparently have back of them a desire to arrange Government maturities so that they will be on practically a self-liquidating basis, a large part of these obligations to be extinguished at maturity from Treasury surpluses and remittances on foreign Government debt.

The chart below shows the changes in the volume of gross public debt outstanding and in average interest rates on the debt. From a high of about $27,000,000,000 in 1919 gross Government debt has been reduced to below $18,000,000,000—a shrinkage which is already giving Government obligations a scarcity value. From the beginning to the end of 1927 Treasury bonds with remote optional dates advanced from about a 3.55 per cent basis to a 3.17 per cent basis. If money and credit remain abundant, a continuance of the 1927 decline in yields to still lower levels may reasonably be expected. The excellent past record of those guiding the destinies of the Treasury suggests that the future value of Government securities may be considerably enhanced.



Municipals

The decided contraction in the volume of new municipal financing since the first of the year has given the market a chance to work off what excess stocks may have been on dealers' shelves. The technical position is apparently sound and in view of the conservative visible supply of new offerings now scheduled by states and municipalities, there is little reason for apprehension over the immediate future. During recent weeks the dealers' problem has been quite as much to buy bonds as to sell them.

The two leading issues of the month were $15,000,000 City of Philadelphia 4s due 1958 and 1978 and offered to yield 3.82 per cent, and $12,000,000 Port of New York Authority Bridge 4s due serially 1938 to 1953 and offered to yield from 3.88 per cent to 3.94 per cent. The steady improvement in the Port Authority credit, as indicated by a gradual price enhancement in its recurring new issues, has been due not alone to the past skillful management of Port finances but also to the thorough distribution which these securities have received at the hands of the underwriting groups. It is now clear that the credit of the Port Authority has been firmly established on a basis comparable with high grade municipals, although the set-up of the Port Authority is such that its bonds differ essentially from strict municipal obligations.

Railroad Issues Active

There was considerable volume of trading in the high grade railroad list during most of the month at slightly rising prices, but the principal activity in the rails took place in the second grade issues. Approval by the Interstate Commerce Commission of the reorganization plan of the Chicago, Milwaukee and St. Paul Railway Company, together with the lifting of the receivership, resulted in broad activity in the bonds of this road. The 4½s and 4s of 1989 were particularly active and reached new high levels. Profit taking later caused a slight reaction, but prices on practically all St. Paul issues continue firm near their recent highs. International-Great Northern Adjustment 6s also received special attention, attaining a new high of 99¼, against a high of 98½ and a low of 83⅜ in 1927. Interest on the bonds became cumulative this year at 6 per cent, whereas a year ago only 4 per cent was declared. St. Louis and San Francisco Adjustment 6s and Income 6s were both active at new high levels, the former selling at 101½ and the latter at 101¼. Prospects for an enlarged volume of railway traffic and improved railway earnings during 1928 are having their effect on the market for railway securities generally.

New Foreign Issues

More than usual interest attaches to a new offering of 50,000 American Shares of the Belgian National Railways Company Participating Preferred Stock which appeared during the month. These American shares are being issued by The National City Bank of New York, as depositary, in the proportion of one American share for five shares of the Belgian issue of a par value of 500 Belgian francs each. The securities were admitted to trading privileges under the Stock Exchange's recently announced policy of encouraging trading here in dollar deposit certificates representing securities of well managed foreign companies. This is one of the first really important issues of this character to be admitted to trading since the rule was promulgated. These participating shares present two rather unusual dividend features: the first, a so-called "fixed dividend" of 6 per cent not finally dependent on earnings but being a direct obligation of the Belgian Government, and the second a "super" dividend equivalent to one-half of the net profits of the railway after certain deductions, a dividend which it is estimated will range between 2 per cent and 3 per cent annually. These American Shares were offered at $85.50 per share and are being traded in currently on the Exchange at around 86⅝.

Another evidence of the growing importance of South America as an outlet for American investment capital is the new issue of $45,-

912,000 Republic of Chile Railway Refunding 6 per cent Gold External Bonds, due January 1, 1961, which was offered during the month at 93½ and interest, to yield 6.48 per cent to maturity. The proceeds of the loan are being used in the redemption of two issues of 8 per cent Dollar bonds of the Republic, repayment of short term indebtedness to the Chilean State Railways, purchase of railway equipment, and repayment of Government advances made for harbor improvements and public works.

During the past year American underwriters publicly offered Latin-American Government securities to the extent of $335,360,300, which was a record for all time. This amount compares with the 1926 total of $317,208,000. The growing volume of Latin-American government flotations in the United tates since 1921 is shown in the following table:

Year	Latin American Government Issues	Total Government Issues	Ratio of Latin American Issues to Total
			Per cent
1921	$ 189,030,000	$ 537,001,214	35.2
1922	186,275,000	619,067,084	30.0
1923	117,500,000	369,802,000	31.7
1924	117,055,000	1,030,784,187	11.3
1925	163,451,000	883,288,500	18.5
1926	317,208,200	669,235,500	47.4
1927*	335,360,300	918,000,000	36.5
Total	$1,425,879,500	$5,027,178,485	28.3

*Tentative figures subject to slight revision.

Declining Long Time Interest Rates

In his report to stockholders at the annual meeting of this Bank, which took place on January 10, 1928, the President, referring to the tendency to smaller profits in industry and trade and lower returns upon capital at interest said:

> The decline in the volume of business has had the natural effect of intensifying competition and thereby narrowing the margin of profits but this tendency must be regarded as a part of the general movement to lower returns upon capital, and while it may be disturbing, it is a condition of progress. * * *
>
> The rise of the market price of securities is significant of a general decline of interest rates and evidences the fact that under the natural law of supply and demand not only investment moneys but current wealth as well must look for lower returns. With a continuance of the existing trend, the Banks of the country must inevitably consider along with the reduction which they find in the interest return upon their assets, a reduction of the rates which they pay on their deposits.

On January 21, Mr. Frederick H. Ecker, Vice-President of the Metropolitan Life Insurance Company, who is charged with making the security investments of that company, addressing a convention of the Company's managers, referred to the investment situation as follows:

> The investment and financial situation of the past year was one of an abundance of money and the lowest interest rates that have obtained in the last three years. This has resulted in a very active bond market and the largest distribution of securities of both home and foreign issues on record. The dealings on the Stock Exchange have been increasing in volume, and on an almost constantly rising price level, attaining the highest price for stocks and bonds since prior to the war. Lacking any disturbing occurrence, the indications are that these conditions may be expected to continue, that bonds will sell at even lower interest returns and stocks maintain their present high levels.

These opinions are based upon the belief that while the expansion of bank credit based upon increasing gold reserves has been an important factor in the rise of security prices and the decline of interest rates, the chief influence has been the increasing production of wealth and increasing supply available for investment. The total increase of loans, discounts and investments of all member banks of the Reserve system in the five years from December 31, 1922, to October 10, 1927, was $7,682,000,000, while the new capital raised by public security offerings in the last year alone, not including refunding issues, as reported by the Commercial and Financial Chronicle, was $7,735,000,000.

It is evident that but for the large purchases of foreign securities the competition for home issues would have been still more active, with corresponding influence upon bond prices and interest rates. As interest rates decline the demand for capital tends to broaden and at some point the rising demand will meet the increasing supply and bring the decline to an end. Just where that point will be reached cannot be predicted with certainty, but there is no reason to think that any permanent recovery above present yields will be established.

Banks are interested in interest rates upon investments, first, because they are large holders of investments. Official reports show that on June 30, 1927, about 30 per cent of the earning assets of member banks of the Federal Reserve system were classed as investments. Furthermore, the returns upon long term investments affect rates for current loans by influencing both the flow of capital and the volume of demand. If rates are relatively high for short term money, new accumulations of capital will flow into that channel while demands for capital will be diverted to the long term market until normal relations between the two classes of loans are restored.

On the other hand, if rates in the short term market are relatively low, new capital will flow into long term securities while demands for capital will turn temporarily to the short term market. In other words, short term and investment funds are always in competition and notwithstanding temporary fluctuations, in the long run both must follow the same trend. If then the long time trend of both is to be downward, there is no escape from the proposition that interest rates on bank deposits must conform thereto.

The Chicago, Milwaukee & St. Paul Reorganization

The Chicago, Milwaukee & St. Paul Railway Company, operating one of the principal railway systems of the country, was placed in the hands of receivers on March 18, 1925. Messrs. Kuhn, Loeb & Company and the National City Company, who had been for many years related to the railroad company as its bankers, proceeded to prepare a plan of reorganization and to confer with committees representing the several groups of bondholders and stockholders whose interests inevitably were more or less diverse and conflicting. Their object and that of the receivers was to preserve the system intact, or as nearly so as would best serve the interests of all concerned, including stockholders, the holders of bonds secured by sections of the system and the residents of the communities depending upon it for transportation facilities; and in doing so to preserve the rights and relative positions of the several parties interested, so far as might be possible.

It may be imagined that this was a task not easily accomplished. That the company's current income was insufficient to meet the interest upon its indebtedness, that its credit was impaired to a degree which rendered it incapable of raising new money either to meet maturing debt obligations or provide for the necessary upkeep and improvement of the property, made it evident that an emergency existed. Something had to be done to take care of the debts that were pressing, secure a respite from the burden of fixed charges, obtain funds needed for equipment and improvements and tide the company over until an increase of earnings would give permanent relief from its difficulties.

Obviously sacrifices had to be made and naturally opinions differed as to how the several parties concerned should share the sacrifices. Inevitably the holders of the common stock came first. The dividends on the common stock were reduced from 7 per cent to 5 per cent in 1912 and none were paid after September, 1917. The holders of the preferred stock were next in order and received no dividends after September, 1917. The holders of underlying bonds secured upon the most valuable divisions of the system, including important terminal properties, were not in danger of loss and no default occurred upon their holdings, hence they could not be called on to participate. The aggregate of these issues which have gone through the reorganization undisturbed is about $182,000,000. The holders of the junior bond issues were interested in maintaining the system as a whole and in placing it in position to raise needed funds and therefore might be expected to make some concessions to accomplish these purposes. The stockholders ranked after the debt-holders, but were entitled to consideration, particularly if they were willing to put new money into the treasury.

These were the conditions with which the reorganization managers had to deal in attempting to formulate a plan which first would secure the cooperation of the various elements in the situation and then obtain the approval of the Courts and the Interstate Commerce Commission. To obtain unanimous cooperation by all parties concerned was not to be expected, but eventually 86.3 per cent of the bonds, 75.5 per cent of the common stock and 73.1 per cent of the preferred stock were deposited with the committees which gave approval to the plan.

All of this took time, as dissatisfied parties contested every step, but on November 22, 1926, the property was sold under foreclosure and bid in for the reorganization managers in pursuance of the plan. The sale was ratified by the Courts, including the Supreme Court of the United States, and on January 10, 1928, the Interstate Commerce Commission, by vote of seven to four, authorized the successor corporation, the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, to issue the new securities proposed, and to take over and operate all of the properties formerly owned by the Chicago, Milwaukee & St. Paul Railway Company, thus putting the plan of reorganization into effect.

The Commission's Investigation

It was inevitable that the announcement of a receivership for a corporation in which the public was so largely interested as in the St. Paul railroad would occasion a great amount of comment upon the causes therefor, and no small amount of random surmises and baseless gossip. The company at the time of the receivership was operating over 11,000 miles of railway, with total operating revenues of over $160,000,000 and capitalization of over $700,000,000. No doubt many people, uninformed as to the difficulties under which it had been laboring, were surprised that a receivership should be necessary, but it is a fact that in seven of the eight years preceding, the railway had been unable to earn its entire fixed charges, and the impairment of its credit was well known.

On May 12, 1925, the Commission, upon its own motion, instituted an investigation into the history, management, financial operations, etc., in order to determine the cause of the receivership. This investigation was conducted by Commissioner Cox, who, however, retired from the Commission before the Report was completed. The Report, approved by the Commission, was given to the public on the same date that the Commission announced its approval of the reorganization plan, but little of the contents has appeared in the newspapers,

a fact which of itself is evidence that the findings are not of a sensational character.

The Report has a critical tone which will acquit it of partiality to the management, but it shows that there was no basis in fact for the vague rumors about dishonesty on the part of the previous management. In connection with the construction of the Puget Sound extension, the work of which was mainly in charge of Mr. E. J. Pearson, now President of the New York, New Haven and Hartford, the Report states that—

> Pearson had had a wide experience in the Pacific Northwest, having been an engineer and operating officer of the Northern Pacific for nearly 23 years, and chief engineer during the last five years of this period. In the light of that experience, and that of various railroads handling construction projects, he built up an organization in such a manner that he was able to keep close to the work of the subcontractors and assure himself of their competency, efficiency, and honesty. . . . It is sufficient to say that the investigation of our Bureau of Valuation did not disclose losses due to dishonest expenditures.

The wisdom of the important expenditures for electrification was questioned. The Company itself made a very careful study of operating economies resulting, and its figures show that for the years 1916-1924 inclusive, the estimated net savings by electrification amounted to $12,400,000. The Commission also made an extensive examination of the underlying data on which the Company's estimates were based, and decided that it was a careful and conscientiously prepared estimate. Even after questioning certain items, the Commission reaches this conclusion:

> "There can be no doubt that the aggregate cost of operating those three divisions by means of electricity has been much less than the cost of operating those three divisions by means of the older type of steam locomotives would have been."

The engineers of the Commission also make a comparison, using not the old type of steam locomotive displaced by electric power, but the most modern and suitable type of steam locomotives, whose efficiency is probably thirty per cent greater than of those in general use in 1915. The fair test of the wisdom of the St. Paul's electrification would seem to come from a comparison of the type of locomotive which was in use when electrification was carried out. Nevertheless, electricity seems to the Commission to have some advantages even over the modern locomotive, for it says:

> "The conclusions to be drawn from the study of our engineers are that if the Rocky Mountain and Missoula Divisions had been operated in 1923 by means of modern and suitable types of steam locomotive, instead of by electricity, the cost would have been about the same, and that the electrification of the St. Paul has probably resulted in some savings. Certainly it has not resulted in losses."

The acquisition of the Chicago, Terre Haute & Southeastern railroad by lease had been a subject of animadversion, and the Report finds that at first considerable losses and additional burdens were imposed on the St. Paul at a critical period. The Report, however, goes on to state that the position of the Terre Haute has been steadily growing better, and that Mr. Byram was right in his judgment that the St. Paul needed such a coal road, and that his judgment has been vindicated by recent results.

The Puget Sound Extension

1\. The Report finds that the construction of the Puget Sound extension was perhaps the chief of the causes that led to the receivership, since that extension failed to earn anywhere near a return sufficient to carry the burden incurred in its construction. The cost of the extension up to 1925 was approximately $257,000,000. It is undeniable that had the Directors foreseen, in 1905 when they determined to build to the Pacific Coast, what conditions would be in the Northwest twenty years later, the St. Paul would not have crossed the Missouri river. They acted in view of existing conditions. The purchase of the Burlington by the Northern Pacific and Great Northern signified that in order to participate in through business between Chicago and the Pacific Coast the St. Paul would have to extend its own rails. The Company was in position to raise the required capital and the prospects for a growing traffic were thought to warrant the undertaking.

2\. Another primary cause of the receivership is said, by the Commission, to be the financial structure, which showed a ratio of 65 per cent funded debt to total capitalization. This was due in part to the Puget Sound extension. However, it might be noted that the Baltimore and Ohio Railroad Company, which successfully refunded over $130,000,000 of debt maturing in the same year that the St. Paul failed, had, at that time, a capital structure of 73 per cent bonds and 27 per cent stock. While it is true that it is desirable to keep the percentage of debt in a corporation's capitalization down to as low a figure as possible, the success of the Baltimore & Ohio in its refunding operations indicates that earnings have a very important bearing. Both the Baltimore & Ohio and the St. Paul suffered severely during the period of Federal control, but the former was able to re-establish its net earning power, while the latter was not.

3\. Low rates

The Part of Rate Regulation

The net return of the St. Paul on its property investment dropped below three per cent in the two years immediately preceding the receivership, which decline was caused, in part, by a decrease in passenger business, and by an almost stationary character of freight business. On the Rocky Mountain and Missoula Divisions of the Puget Sound extension, the freight traffic handled in 1923 and 1925 was almost exactly the same as in 1915, while that handled over the Coast Division in those years was less than in 1915. The export and import trans-

continental business through the ports of Seattle and Tacoma dropped from 457,000 tons in 1918 to 42,000 tons in 1925. This decline of total available volume in some classes of traffic and a stationary volume in others hardly would have been foreseen by anybody familiar with the previous growth of the western part of the United States.

More serious, however, than this disappointment as to volume of traffic was the rise of operating costs, due to the war (likewise unforeseen) and of certain rate decisions by the Interstate Commerce Commission. The Commission apparently admits that its own actions were not without influence in precipitating the receivership. After calling attention to advances in rates made in 1920, following Ex Parte 74, amounting to 35 per cent in the Western Group, 25 per cent in the Mountain Pacific Group, and 33 1-3 per cent in interterritorial rates, the Report states—

"However, soon afterwards, we rendered three decisions which affected the St. Paul materially. Receiver Potter estimates that the reduction in live stock rates reduced the net of the St. Paul approximately $1,400,000 annually, while the decision in rates on grain, grain products, and hay took $3,400,000 annually from the net. Following this decision, a general reduction of 10 per cent in all rates not reduced that much in the two previous cases cited, was made in accordance with our decisions in Reduced Rates, 1922. This reduction, Potter estimates, cost the St. Paul $14,000,000 annually. It is probable that had the St. Paul continued to realize the full increased revenues authorized in Ex Parte 74, assuming that the traffic would have held up under such rates, the Company would have been in a fairly comfortable position with sufficient credit to finance its maturities, and thus, avoid receivership."

Every rate cut diminishes net earnings by the full amount of such reduction. In the St. Paul case, the reductions above referred to aggregated $18,800,000 per annum, so that its net earnings were reduced by an amount equal to eighty-seven per cent of the fixed charges of the old Company, which were $21,544,000.

If the Directors of twenty years ago can be criticized for a lack of foresight, the Commission would seem to have a share of the responsibility, for they reduced rates within three years of the receivership, in the face of their own knowledge that in the Northwestern region the carriers were not earning 5¾ per cent on any reasonable rate base, and that the least favorable conditions existed in the Western Trunk Line Territory, where the St. Paul mileage principally lies. The Commission summarizes its action on the effect of the rate reductions on the situation as follows:

"The law with respect to the regulation of freight rates is, in our opinion, ample and adequate for the protection of both shippers and carriers. Whether the Commission has administered that law wisely and justly, others must decide. Our published reports contain the reasons for our decisions."

Plan of Reorganization

The principal features of the Plan of Reorganization are the reduction of fixed charges by $7,881,000, or 37 per cent, to $13,663,000; the liquidation of the debt owing to the United States Government of $55,000,000 for $52,000,000 cash and $3,000,000 preferred stock; and the creation of a new mortgage for future financing which ranks immediately behind the undisturbed obligations of the old St. Paul. The cash requirements are met by an assessment on the stockholders of $70,000,000.

The bonds of the old Company in default aggregate $228,600,000. All of these bonds receive for twenty per cent of the principal a fifty-year 5 per cent mortgage bond, ranking immediately behind the new financing mortgage, and for the remaining eighty per cent of the principal, convertible adjustment mortgage bonds, entitled to 5 per cent interest, cumulative after 1930, and convertible into equal amounts of preferred and common stocks at par.

A holder of one hundred shares of preferred stock pays an assessment of $2,800 and receives $2,400 of fifty-year 5 per cent bonds, of the same issue as the bondholder receives, for twenty per cent of his principal, and also one hundred shares of the preferred stock of the new Company, entitled to 5 per cent dividends, and participating with the common after $5 is paid on that stock. The holder of one hundred shares of common stock pays $3,200 and receives $2,800 of fifty-year 5 per cent bonds and one hundred shares of no par common stock in the new Company.

The properties of the old St. Paul were sold at foreclosure for $140,000,000, and the bondholders not depositing under the plan are entitled to receive only their distributive share of the proceeds of the sale, while non-assenting stockholders receive nothing. The right to deposit securities under the reorganization plan terminates on February 16.

The assessment on the stockholders is called for on February 16, but may be paid in two installments, the second payment being required not later than June 1.

Prospects of the Company Under the New Capitalization

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company has taken over the physical properties of the old Company, subject to assumed obligations of the Company, amounting to about $182,000,000, and has issued $106,000,000 of fixed interest 5% fifty-year mortgage bonds, $183,000,000 of adjustment convertible bonds, $120,000,000 of preferred stock, and 1,174,000 shares of no par common stock.

The physical properties of the Company have been greatly improved under the receivership, among other things, 1,400 miles of line have been relaid with new and heavier rail, and 10,000,000 cross-ties have been put under

the track. Inefficient locomotives and uneconomical freight cars have been retired, and considerable new equipment has been purchased. The road should be able to give first-class service in its territory.

The average net income available for interest for the years 1924-1926, inclusive, was approximately $19,500,000, and as the fixed charges of the new Company are $13,663,000, it is evident that such charges are safely covered, especially when consideration is given to the fact that the period covered was one of unfavorable conditions in the Northwest, and, further, that during the period of receivership, very liberal charges to operating expenses for maintenance, equipment retirements, etc. were made.

The majority of the Commission in authorizing the new securities state that the plan sets up a financial structure that leaves something to be desired from the point of view of fully sound financial standards, but they believe that the major public interest required that the properties be released from receivership at the earliest possible moment.

Criticisms of the Plan

The minority make the criticism that the interest charges on the new funded debt, including the requirements of the adjustment mortgage bonds at 5 per cent, exceed the fixed charges of the old Company by $1,263,000 per annum. They then argue that unless earnings in the future are much better than those of the past, earnings on the stock will not be large, and the Company will, therefore, be forced to finance its future capital requirements by issues of new mortgage bonds, and will not be able to finance by new issues of stock. What the St. Paul earned in the past is not necessarily a safe index to use in determining what it may earn in the future. For a number of years prior to the receivership, the Company was greatly hampered by its inability to raise capital. Also, it is known that business conditions in the territory served by the Railway have been abnormally depressed since 1920. Messrs. Coverdale and Colpitts, who made an expert examination of the property, estimated in 1925 that by 1931 the earnings available for the adjustment bond interest of $9,143,000 should be $15,013,000.

A more recent estimate has been prepared by the railway company officials, and shows that net operating railway income for the first five years of operation by the new Company should be as follows—First year, $20,015,000; second year, $23,370,000; third year, $24,770,000; fourth year, $28,005,000; and fifth year, $29,970,000. Admitting that general conditions may prevent as rapid a restoration of earning power as occurred following the receiverships of the Union Pacific and the Northern Pacific in the nineties, or in the case of certain Southwestern roads, which were reorganized a few years ago, it does seem reasonable to anticipate steady improvement in the earning power of reorganized St. Paul. This should follow as a result of the more favorable conditions that now prevail in the Northwest, and from the ability of the new Company to command capital as needed. Mr. Mark W. Potter, one of the receivers, stated that there are many situations on the road where expenditures will bring about economies which will mean a saving of 25 per cent, 50 per cent, and even 75 per cent a year.

The Treatment of Stockholders

The minority opinions also criticize the plan on the ground that the stockholders are admitted into the new Company without serious sacrifice. What they are called upon to do is to invest $24 a share in the case of the preferred stock, and $32 a share in the case of the common stock in the new 5 per cent Bonds at par, and to pay, in addition, $4 a share, which makes an aggregate assessment of $70,000,000. The bonds the stockholders take at par are now selling at about 96, so that, in addition to the $4 a share, the stockholders make an additional contribution represented by this discount. It should be remembered, however, that when this plan was first prepared, three years ago, general market conditions were very different, and in the judgment of the reorganization managers any heavier burden than contemplated by the plan would have virtually extinguished the stockholders' equity. In this connection, Commissioner Eastman writes:

> "There is much to be said in favor of forbearance and generosity in the treatment of stockholders, especially where, as here, the stock has commanded high prices in the past, and for the most part, has beneath it an adequate margin of rate base value upon which the carrier is justly entitled to earn a reasonable return. It would be most unfortunate, from the public viewpoint, if they were to be wiped out."

After presenting this apparently reasonable view the Commissioner sets over against it the suggestion that bankruptcies and reorganizations afford opportunities for manipulation, and that the stock may have passed from the hands of the former holders into the hands of speculators. In the absence of any information upon that point, it would seem that to make it the basis of action against all shareholders would lay the plan open to more serious criticism than any that has been offered.

Bankruptcies are unfortunate occurrences, particularly in the case of great properties in which ownership is widely distributed. The value of the shares inevitably is affected, but the fact that some of the shares change hands surely is not a sound reason for denying the rights of shareholders as a class. It seems not too much to say that the suggestion is irrelevant, since if carried to the logical conclusion

it would always prevent shareholders from having any part in reorganizations. Manipulation can always be suggsted and it is inevitable that when a corporation is in difficulties more or less of the stock will change hands.

The provisions of the plan touching the rights of shareholders have not been altered since the plan was first offered in 1925, and if they are more favorable to shareholders now than they appeared to be then it is because of changes in the general position of railroad shares and the state of the money market which have occurred in the meantime.

If a plan were promulgated today, it might take a different form from that presented in 1925. The only fair way to judge the equity of the plan is to give full consideration to the market and other factors which existed when it was published. A plan is an agreement between reorganization managers and security holders who deposit under it. Therefore, any change, materially affecting the interests of any class of depositors, gives them the right to withdraw, and usually necessitates starting afresh, and prolonging considerably the time of receivership. The majority of the Commission recognize the weight of these considerations.

A final value has not yet been set on the St. Paul property, but the Commission indicates that its value, following the methods of the O'Fallon case, is not less than $640,000,000. The Company, however, contends for a higher figure. Nevertheless, even on the O'Fallon basis, the fixed interest indebtedness is only 45 per cent of the value of the property. The 6 per cent which the Company is entitled to receive before being subject to recapture of earnings, amounts to $38,400,000 per annum. If conditions in the railway industry generally, and in the Northwest particularly, permit the Company to secure such earnings, there will be no question about the ability of the Company to do stock financing, and the position of the old bondholder will be, in respect to income, more favorable than before the receivership.

Commissioner Eastman, in his dissenting opinion, has outlined his own plan of reorganization, under which the defaulted bondholders would receive par for par a 5 per cent preferred stock, open for further issues, at various dividend rates, and subject, in addition to the undisturbed bonds, to an open financing mortgage, and to an open prior preference stock. This proposal has one serious defect, viz: that it affords no basis for a belief that the bondholders would be willing to accept it.

It will be recalled that as the plan was first issued, the old bondholders were to receive one hundred per cent of their principal in adjustment bonds. Opposition, principally from savings bank holders, resulted in modifications, enabling the bondholder to receive 20 per cent of principal in a fixed interest bond. Still other interests attempted to secure further modifications, aiming to give the bondholder forty per cent in a fixed interest bond. In view of these facts, it would hardly be likely that the offer of a junior preferred stock for the full amount of principal would be acceptable.

To perfect a reorganization plan, opposing interests must be harmonized, which usually means a series of compromises. Manifestly, the problem of working out a plan increases as a result of wider diffusion of securities. In the St. Paul case, over 40,000 institutions and private interests scattered over the United States and Europe were affected. The members of the Bondholders' Protective Committee owned or directly represented an exceptionally large amount of the defaulted issues, and the Stockholders' Committee likewise were well qualified by expert knowledge to represent the owners of preferred and common stocks. Every effort was made, and we think successfully, to deal justly with the interests of each class of security. The capitalization is an honest one, fully supported by actual property values. If the growth of population and traffic in the Company's territory follows a normal course and the Interstate Commission does not insist upon giving all of the benefits of new operating economies to the public, there is every reason to expect that the new organization will be justified and that the Company will have a prosperous career.

THE NATIONAL CITY BANK OF NEW YORK

STATEMENTS OF CONDITION

at the close of Business December 31, 1927

FIRST NATIONAL BANK in Minneapolis

RESOURCES		LIABILITIES	
Loans and Discounts	$ 52,828,138.47	Capital Stock . . .	$ 5,500,000.00
Overdrafts	8,118.82	Surplus	5,000,000.00
U. S. Government Securities	15,752,000.00	Undiv'ded Profits . .	604,342.27
Other Bonds and Securities	14,674,435.18	Dividends Payable, December 31st, 1927 . .	330,000.00
Bank Buildings	1,135,000.00	Reserved for Interest Expenses and Taxes .	504,037.40
Customers' Acceptance Liabil ty (Less Anticipations)	1,465,546.00	Interest Collected but not Earned	194,830.19
Bankers Acceptances Purchased	1,050,000.00	Circulat'on . . .	1,678,200.00
Interest Earned but not Col'ected	431,700.82	Letters of Cred:t and Acceptances . . .	1,642,498.94
Cash on hand and due from Banks	23,375,548.00	DEPOSITS . . .	95,266,578.49
	$110,720,487.29		$110,720,487.29

L. E. Wakefield, President

F. M. Prince, Chairman Board of Directors

F. A. Chamberlain, Chairman Executive Committee

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P. J. Leeman
J. G. Byam
G. W. Buffington
Arthur P. Kemp
Fred Sp[illegible]ord
J. Clayton
G. Woods Smith
W. A. Volkmann
Lyle W. Scholes
A. G. Bjerken
A. H. Quay
Vincent McLane

Cashier
S. H. Bezoier

Assistant Cashiers
John G. Maclean
Walter A. Meacham
C. B. Brombach
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Asst. Vice-President
M. O. Grangaard

Comptroller
K. M. Morrison

Assistant Comptroller
A. E. Wilson

FIRST MINNEAPOLIS TRUST COMPANY

RESOURCES	
Guaranty Fund (Bonds and Mortgages with Supt. of Banks)	$ 304,250.00
Mortgages on Rea' Estate	3,209,532.96
Vaults, Furniture and Fixtures . . .	143,599.42
Loans and Discounts .	6,890,075.16
United States Government Securities . .	2,808,422.98
Other Bonds and Securities	11,124,374.62
Customers' Liability Acct. Letters of Credit and Acceptances	70,195.00
Trust Advances Secured	304,492.72
Accounts Receivable .	183,020.19

RESOURCES—Continued	
Overdrafts . . .	3,288.08
Cash and Due from Banks	6,396,058.71
Total Resources	$ 31,437,309.84

LIABILITIES	
Capital Stock . . .	$ 1,000,000.00
Surplus	1,000,000.00
Undivided Profits . .	400,000.00
Reserved for Taxes . .	84,734.82
Letters of Credit and Acceptances . . .	70,195.00
DEPOSITS . . .	28,882,380.02
Total Liabilities	$ 31,437,309.84

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Elbridge C. Cooke, Chairman Board of Directors

W. H. Lee, Chairman Finance Committee

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H. C. Clarke
C. T. Jaffray
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Auditor
Delmar E. Kulp

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